Scholarships, Fellowships, and interplay with the NCAA rules

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Agenda

- Overview of IRC Section 117
- Compensation for Services provided
- Qualified Tuition Reduction
- Athletic Scholarships and the NCAA Rules
- Recordkeeping and Reporting Requirements
- Common questions on campus
When determining whether a payment is excluded from income under IRC Section 117 as a scholarship or fellowship, three questions commonly arise:

- Is the payment a “qualified scholarship”?
- Is the payment compensation for services?
- What are the reporting requirements?
Before we begin, some definitions

- **Scholarship**
  - An amount paid or allowed to, or for the benefit of, a student, whether an undergraduate or a graduate, to aid such individual in pursuing his studies

- **Fellowship**
  - An amount paid or allowed to, or for the benefit of, an individual to aid him in the pursuit of study or research

- **Scholarship and fellowship payments are treated the same for income tax purposes** (Regulations 1.117-3)
Overview of IRC Section 117
Overview of Section 117

- IRC Section 117(a) excludes certain scholarship amounts from income:
  - Payment must be a “qualified scholarship”
  - Recipient must be a “candidate for a degree”
  - Amount must be used for attendance at an “educational organization”
Overview of Section 117 (cont.)

- Qualified scholarship (defined in IRC Section 117(b):
  - A payment for either (1) tuition and fees required for enrollment or (2) fees, books, supplies or equipment required
  - Does NOT include room, board, living expenses, travel, research, etc
  - Does NOT include payments for teaching, research, or other services
  - Any excess amounts are taxable
Overview of Section 117 (cont.)

- Candidate for a degree
  - Undergraduate and graduate
  - Full or part-time
  - Degree seeking or non-degree seeking students

- Educational organization (as defined in IRC Section 170(b)(1)(a)(ii))
  - Regular faculty and curriculum
  - Regularly enrolled student body
  - Place where educational activities are regularly carried on
Overview of Section 117 (cont.)

- Section 117(c) – neither the “scholarship” nor the “qualified tuition reduction” exclusion shall apply to any amount “which represents payment for teaching, research, or other services”

- Section 117(d) – excludes amounts received as a “qualified tuition reduction” and defines that term
Compensation for Services provided
Section 117(c): Compensation for Services

- If an individual must teach, research, or otherwise provide services, then neither the qualified scholarship nor the qualified tuition reduction provisions apply to any compensation the individual receives for teaching, researching, or other services
  - Exceptions for National Health Services Corps Scholarship and Armed Forces programs
Section 117(c):
Compensation for Services (cont.)

• If a scholarship or fellowship represents a payment for past, current, or future services then the payment is considered wages
  – Depends on whether a student is required to perform the services as a condition of receiving the grant (Prop. Reg. Section 1.117-6(d)(2))
  – Tax treatment does not change if all students are required to perform such services
Section 117(c):
Primary Purpose/Primary Benefit

- Are the student’s activities for the primary benefit of the educational organization or do they further the student’s education and training?
  - Direction or supervision over the student’s activities
  - Is the research (i.e. rights to the patent) for the benefit of the educational organization?
Section 117(c): Distinguishing Compensation for Services Rendered

- Determine if services are provided
- If so, determine the value of services
- Compare value of services with amount (if any) treated as wages
- If value exceeds wage amount, difference is recharacterized as wages
How Does IRS Determine the Value of Services

- Prop. Reg. Section 1.117-6(d)(3) suggests the following be considered:
  - Amount paid to non-scholarship students for similar services
  - Amount paid to non-students for similar services
  - Amount paid by other colleges and universities for similar services
Qualified Tuition Reduction
117(d) Tuition Reduction

• Section 117(d) excludes the amount of tuition reduction provided by a college or university to an employee of the institution
• Benefit only applies to “tuition” and does not cover fees, books, etc.
• Benefit also applies to courses taken at another educational institution
Education Covered

• Reduced tuition must relate to education “below the graduate level”
• IRS looks to status of student, not status of course; therefore, a graduate course taken to satisfy undergraduate degree is OK
• Exception for graduate teaching/research assistants
Individuals Covered

- Person must be “employee” of college or university
- “Employee” includes:
  - Retired employees
  - Disabled employees
  - Widows or widowers of active, retired, or disabled employees
  - Spouses and dependent children of employees
Nondiscrimination Rules

- IRS looks to qualified plan nondiscrimination rules for guidance, but does not follow those rules absolutely.

- What if a school routinely grants tuition reduction benefits to ineligible employees? Will this jeopardize qualification under Section 117(d)?
Special Rule for Teaching and Research Assistants

• Faculty/staff who may be engaged in teaching/research activities at the graduate level may also be eligible for tuition assistance, but not necessarily under the benefit of IRC Section 117(d):
  – Utilizes the fringe benefit rules of IRC Section 132 (see PLR 9040045)
• IRS would also presumably say the exception does not apply to non-teaching/research students
  – See PLR 100237041
• Jim Brown is a graduate student at X University and, as part of his program, works as a research assistant in the University’s chemistry department.

• Jim receives a cash stipend of $15,000 and tuition reduction valued at $12,000.

• X treats Jim as an employee and the $15,000 stipend as taxable wages, but treats the tuition reduction as a nontaxable qualified tuition reduction under section 117(d).
Example (1) – cont.

- Treatment is correct assuming that the $15,000 stipend represents FMV compensation for the research services.
- Jim’s $12,000 tuition reduction is excludable from under section 117(d) even though Jim is a graduate student.
- Section 117(c) does not apply because the $12,000 tuition benefit does not represent a “payment for services” required as a condition for receiving the tuition reduction.
Example (2)

- Same facts, except that the FMV of the research services that Jim performs for the University is $27,000.
- The $12,000 tuition reduction becomes taxable wages income to Jim under section 117(c) because the $12,000 tuition benefit is a payment for services that are required as a condition for receiving the tuition reduction benefits.
Example (3)

- Same facts, except that FMV of Jim’s research services is $20,000.
- In this case, $5,000 of the $12,000 tuition reduction will be treated as taxable wages under section 117(c).
- The remaining $7,000 in tuition reduction can be excluded under section 117(d).
Athletic Scholarships and the NCAA Rules
Athletic Scholarships
Revenue Ruling 77-263

• Addresses tax treatment of athletic scholarships considering the following facts:
  – Scholarship was awarded based on the student’s athletic abilities
  – University did not require participation in a sport, although it was expected
  – University did not require any other activity in lieu of playing the sport
  – Once scholarship was awarded, university could not terminate it even if the student was injured or decided not to play the sport
Athletic Scholarships
Revenue Ruling 77-263 (cont.)

• At the time of the ruling, incidental expenses such as room and board were not considered taxable

• Current rules would treat scholarship amounts for room and board as taxable income
NCAA Rules

• Division I and II schools can offer athletic scholarships; Division III schools can offer academic scholarships

• Scholarships have to be for at least one academic year; Division I schools can offer multi-year scholarships
NCAA Rules (cont.)

• Division I and II institutions are permitted to provide a student-athlete with tuition and fees, room, board and required course-related books.
  – Providing for room and board would be taxable under IRC Section 117
  – NCAA rules prohibit a school from making a payment to an athletic scholarship recipient (i.e. if school pays the applicable withholding on behalf of the student)
Athletics - Areas of Concern

- 5th year ineligible athletes v wage earners
- Team Managers v Team Players v wage earners
- Interns – generally wages
Recordkeeping and Reporting Requirements
Reporting and Recordkeeping

- Treas. Reg. 1.6041-3(n) (IRS Notice 87-31)
  - Scholarship or fellowship grant is not subject to income, social security, or federal unemployment tax withholding; and no information or other return reporting is required (special rules for NRAs discussed later)

UNLESS

- Treated under IRC Section 117(c) as a payment in return for services rendered
Reporting and Recordkeeping: US Students

- No reporting responsibilities for payments to a US tax resident if amounts are
  - Considered a qualified scholarship
  - Not considered compensation for services
  - Consider 1098-T reporting requirements
- If considered a payment for services
  - W-2 reporting and withholding required
Reporting and Recordkeeping: Nonresident Aliens

- IRC Section 1441(a) provides guidance
  - General rule is that a withholding is required on taxable income of nonresident aliens
  - Many exceptions apply (tax treaty, individuals in the US on a visa, etc.)

- Taxable portions of payments made to nonresident alien students must be reported on Form 1042 and 1042-S
Form 990 Reporting

• Schedule I – scholarships and grants to US individuals
  – Report information if aggregate amount of grants exceeds $5,000

• Schedule F – scholarships and grants to foreign individuals
  – Report information if aggregate amount of grants exceeds $5,000

• TD F 90-22.1 – foreign bank account
QUESTIONS?
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